Supreme Court, U.S.
FILED
FEB 13 1986
CLERK

Nos. 85-1219 & 85-1252

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

TRANSWESTERN PIPELINE COMPANY,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

ARKLA ENERGY RESOURCES,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

On Petitions for Writs of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF OF RESPONDENT TEXAS GAS TRANSMISSION CORPORATION IN SUPPORT OF THE PETITIONERS

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QUESTION PRESENTED

Whether section 5 of the Natural Gas Act permits the Federal Energy Regulatory Commission to revoke or modify longstanding certificates of public convenience and necessity, issued under section 7 of the Act, by forbidding enforcement of contractual provisions for minimum commodity bills or minimum purchase obligations that are incorporated in those certificates.*

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* The parent companies and affiliates of respondent Texas Gas Transmission Corporation are listed in Appendix A, *infra*.

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15 U.S.C. § 717d	*passim*
15 U.S.C. § 717f	*passim*

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STATEMENT

Respondent Texas Gas Transmission Corporation ("Texas Gas") operates an interstate pipeline for the transportation of natural gas under certificates of public convenience and necessity issued by the Federal Energy

Regulatory Commission ("FERC") and its predecessor, the Federal Power Commission ("FPC"), pursuant to section 7 of the Natural Gas Act of 1938 ("NGA"), 15 U.S.C. § 717f. The certificates at issue in this case make express reference to and incorporate specific contracts with provisions for minimum commodity bills that assure Texas Gas a minimum volume of sales. R. 496.[1] This assurance was a fundamental condition of Texas Gas's application for and acceptance of the certificates. R. 494, 1123.

In the administrative proceeding below, the FERC determined that all minimum commodity bills, even including those incorporated in a pipeline company's certificated authority, are "unjust" and "unreasonable" within the meaning of section 5 of the NGA, 15 U.S.C. § 717d. This determination will have a particularly adverse effect on Texas Gas. Approximately one-half of Texas Gas's total sales are made pursuant to contracts with "partial requirements" customers that have many alternative sources of supply. R. 493-96. Because these customers are located at the terminus of Texas Gas's interstate pipeline system, the preponderance of Texas Gas's investment in pipeline facilities necessarily was incurred to render service under these contracts. R. 484-85. Before the FERC ruled, these contracts prescribed roughly symmetrical obligations: Texas Gas had a firm obligation to deliver up to 100 percent of the contract amount, and the purchaser had a stated minimum obligation to buy at least 75 percent of that amount. The FERC's order destroys this symmetry. Without the assurance of minimum sales volumes to these customers, "50% of [Texas Gas's] market can swing from zero to 100% of contract demand." R. 496.

The FERC's order therefore goes to the very core of the nature of Texas Gas's contractual undertakings. Whereas Texas Gas previously was a supplier of baseload

[1] "R." refers to the joint appendix in the court of appeals.

service, its partial requirements customers now may unilaterally relegate it to the role of a supplier of peaking service only. The agency historically has recognized a clear distinction between baseload and peaking service:

> A pipeline would not normally be built to supply peak service, that is to say, service on the peak days only. . . . [P]ipelines are built to supply service not only on the few peak days but on all days throughout the year. In proving the economic feasibility of the project in certificate proceedings, reliance is placed upon the annual as well as the peak deliveries. Stated another way, the capital outlay for the pipeline facility is made—and justified—not only for service on the peak days but for service throughout the year.

Atlantic Seaboard Corp., 11 FPC 43, 54 (1952). The differences between baseload and peaking service affect not only the design of and investment in the pipeline but also the nature of the gas purchase contracts entered into by the pipeline to support such service. *See* Pet. 9 n. 9 (No. 85-1252).

Texas Gas's sudden demotion from a baseload to a peaking service supplier makes rational planning impossible and has serious economic implications. As a result of the FERC's order the majority of Texas Gas's partial requirements customers have reduced their purchases to levels far below the 75 percent minimum required by contract. This puts Texas Gas on the horns of a dilemma. Either Texas Gas must arrange for a decrease in the volumes it is committed to purchase under its supply contracts, thereby subjecting its full requirements customers to the likely curtailment of deliveries in the event that they demand full contract quantities; or Texas Gas must continue in force its existing contracts with producers and face the risk of very substantial liability resulting from its inability to purchase at the minimum levels required by the take-or-pay provisions

in such contracts, costs which may be borne by its full requirements customers. R. 495-96.[2] If Texas Gas had known that it was being certified to perform a service which its partial requirements customers could convert unilaterally to peaking only, or that its certificate was subject to modification to that effect, it would not have accepted the certificate and would not have made the substantial investment that was required in order to construct its pipeline and to perform its certificated base-load service. R. 1123. After making this investment and after entering long-term contracts for the supplies necessary to provide this service, Texas Gas has had its market unfairly and unexpectedly truncated by regulatory fiat.

There is no countervailing public benefit. Texas Gas is a low-cost supplier. R. 1109. But its partial requirements customers are other interstate pipelines that also acquire natural gas directly from producers. As a direct consequence of the FERC's order, "lower-cost purchases from Texas Gas have been cut back as a result of a pipeline customer's attempt to meet its take-or-pay minimums for higher cost producer supplies." R. 1110. The FERC's order, in other words, has the irrational result, at least in Texas Gas's instance, of diverting purchases from low-cost to high-cost supliers.

On petition for reivew before the court of appeals, Texas Gas contended that the FERC's order constituted an impermissible revocation or modification of its certificated authority. The court brushed this contention aside in a footnote:

> Section 7, which vests in the Commission control over the conditions under which gas may initially be dedicated to public use, does not guarantee that the

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[2] Take-or-pay provisions in contracts with producers, even though they are the functional equivalent of pipelines' minimum commodity bills, are not affected by the FERC's order. Pet. App. A-37 to A-40 (No. 85-1219).

> initial terms of that service will never change. *See* Atlantic Refining Co. v. Public Service Commission of New York, 360 U.S. 378, 389 (1959). Even assuming *arguendo* that the Commission has no authority to amend or revoke certificated service in a section 5 proceeding, the elimination of minimum bills has no affect on the pipeline's *authorized* service. The Order merely addresses the *rates* the pipeline may charge its customers and therefore was properly issued pursuant to section 5.

Pet. App. A-25 n.9 (No. 85-1219) (emphasis in original).

ARGUMENT

By permitting the effective revocation or modification of certificated authority, the decision below establishes an unfortunate precedent that will discourage pipeline companies and their investors from undertaking certificated service in the future. The decision misconstrues the proper relationship between sections 5 and 7 of the NGA and is inconsistent in principle with *United States v. Seatrain Lines, Inc.*, 329 U.S. 424 (1947). The Court should grant certiorari to review this important case.

1. Natural gas pipelines are very expensive and highly capital-intensive undertakings. Once constructed, the physcal equipment—the pipeline itself—cannot be converted to other uses. Interstate pipelines are not built on speculation. They are built to service identified markets and customers in accordance with specific long-term contractual arrangements. They are built and operated, moreover, in accordance with certificates of public convenience and necessity, issued by the FERC pursuant to section 7 of the NGA, that confirm the nature and scope of the service to be performed.

In applying for a certificate, a pipeline company is required to specify the essential elements of the service it is willing to perform, and its decision to accept a certificate depends upon receipt of authority to perform those essential elements of service. Thus, a company

which specifies that it is applying for authority to perform baseload service may refuse to accept a certificate that would give its customers the unilateral option of converting to peaking service. In this way, the company can be assured at the outset that the nature and scope of the service to be performed will support the required level of investment in facilities, personnel, and long-term purchase commitments.

If the pipeline company's certificated authority were subject to involuntary revocation or modification by the FERC, the necessary degree of assurance would be lacking:

> massive investments must be and are made to construct facilities in reliance on the conditions and permanence for the prescribed term of the certificates issued by the Commission. Without such security, businessmen and investment institutions would not enter into such projects nor lend the necessary funds to make the projects possible.

Trunkline LNG Co., 22 FERC ¶ 63,028 at 65,138, *aff'd*, 22 FERC ¶ 61,245 (1983). It has long been understood that the NGA provides the necessary assurance to pipeline companies and investors. Section 7, which governs the issuance of certificates, makes no provision for revocation or modification by the FERC except upon the request of the carrier itself. Almost forty years ago this Court held in *Seatrain Lines*, 329 U.S. at 429-32, that a certificate of public convenience and necessity may not be modified or revoked in the absence of express statutory authority. *See also CAB v. Delta Air Lines*, 367 U.S. 316, 321-25 (1961). Congress, in order to induce and protect investments in interstate pipelines, has never amended the NGA to provide such authority.

The decision below radically alters the statutory scheme. It permits the FERC, in the guise of exercising control over the justness and reasonableness of rates under section 5 of the NGA, actually to revoke or modify the essential elements of service incorporated in a certifi-

cate. The FERC's exercise of this novel power in this case unfairly defeats the settled expectations of pipeline companies and investors and introduces a damaging element of uncertainty into all future interstate pipeline undertakings.

Further, the FERC's order defeats the regulatory objective of reliable service. A hallmark of the NGA is its requirement that service be provided not at the lowest rate possible but at the lowest rate "consistent with the maintenance of adequate service in the public interest". *Atlantic Refining Co. v. Public Service Commission of New York*, 360 U.S. 378, 388 (1959). By granting partial requirements customers the unilateral option of swinging from baseload service to peaking service, the FERC has impaired the ability of pipeline companies to maintain adequate service. In the absence of assurance that purchases will be maintained at a minimum level, it is impossible for a company to determine from year to year what level of service its partial requirements customers will demand. R. 475-79, 496. Accordingly, pipeline companies are placed in a position of having either inadequate supplies under contract, with consequent curtailment of service to all customers, or a surplus of supply, with attendant take-or-pay costs borne by full requirements customers.

2. The court of appeals justified this result on the ground that minimum commodity bills and minimum take provisions are "rates" that the FERC can change under section 5 even when they are incorporated in a pipeline company's certificated authority. But minimum commodity bills and minimum take provisions are not "rates." By defining the service obligation by reference to a minimum volume of natural gas, such provisions go to the essential nature of the service—baseload rather than peaking—and not merely to the price at which that service will be furnished. If the FERC had confined its attention simply to "rates," Texas Gas, as a low-cost supplier, would have had no complaint. The heart of

the problem is that the FERC has relieved Texas Gas's customers of their obligation to pay for a minimum volume of gas at any price.

To be sure, section 5 gives the FERC authority not only over "rates" but also over any "charge, classification, rule, regulation, practice or contract." Those very general statutory terms could be construed to cover each and every feature of certificated authority. But to construe section 5 expansively, as the court below has done, would allow the FERC to invalidate in its entirety a contract that defined the scope of certificated authority and thereby completely destroy the integrity of the certificate issued under section 7.

By omitting any provision for involuntary revocation or modification in section 7, Congress clearly evidenced its intention to protect the pipeline company against this type of involuntary and fundamental change in the nature and scope of its certificated service. The court below seriously erred in construing section 5 in a manner that fails to harmonize with the objectives of section 7. Section 5 should not be read to authorize involuntary changes in essential elements of certificated service.

CONCLUSION

The petitions for writs of certiorari should be granted.

Respectfully submitted,

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APPENDIX A

Texas Gas Transmission Corporation is wholly owned by Texas Gas Resources Corporation, which in turn is wholly owned by CSX Corporation.

CSX Corporation owns partial interests in the following subsidiaries:

Atlanta and West Point Railroad Company
The Baltimore and Ohio Railroad Company
The Baltimore and Philadelphia Railroad Company
Chicago South Shore and South Bend Railroad
The Cleveland Terminal and Valley Railroad Company
Dayton and Michigan Railroad Company
Dayton and Union Railroad Company
Eastern Hardwoods, Inc.
Fruit Growers Express Company
James Center Development Company
Littleton Fuel Company
Louisville, Henderson & St. Louis Railway Company
Mid Allegheny Corporaton
Monon Coal Company, Inc.
Nashville & Decatur Railroad Company
New Ganly Coal Corporation
North Charleston Terminal Company
Richmond, Fredericksburg and Potomac Railroad Company
Richmond-Washington Company

Neither Texas Gas Transmission Corporation nor Texas Gas Resources Corporation owns a partial interest in any subsidiary.